92-398

Supreme Court, U.S.
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No. 92-___

In The

Supreme Court of the United States

October Term, 1992

AMERICAN GENERAL LIFE INSURANCE CO.,

Petitioner,

vs.

JOHN R. DeSHURLEY, et al.,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the common-law doctrine of respondeat superior overrides the "good faith" language of section 20(a) of the Securities Exchange Act of 1934 and subjects principals to strict liability for violations of section 10(b) of that Act and rule 10b-5 by their agents.

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OPINIONS AND ORDERS BELOW

The order of the district court was not reported, but is attached. (Pet. App. A.)

The opinion of the United States Court of Appeals for the Ninth Circuit was not reported, but is attached. (Pet. App. B.) The order of the United States Court of Appeal for the Ninth Circuit denying a petition for rehearing was also not reported, but is attached. (Pet. App. C.)

JURISDICTION

The memorandum opinion of the court of appeals was filed on March 19, 1992. A petition for rehearing was denied on June 8, 1992.

Jurisdiction in this Court is invoked under 28 U.S.C. section 1254(1).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved in this case are set forth in full in the appendix. (Pet. App. D.) The citations to the statutes and regulations are as follows:

Securities Exchange Act of 1933,
Section 12(2), 15 U.S.C. § 771(2)
Section 15, 15 U.S.C. § 77o
Securities Exchange Act of 1934,
Section 10(b), 15 U.S.C. § 78j(b)
Section 20(a), 15 U.S.C. § 78t(a)
Section 28(a), 15 U.S.C. § 78bb(a)
Securities and Exchange Commission,
17 C.F.R. § 230.405
17 C.F.R. § 240.10b-5
17 C.F.R. § 240.12b-2

I.

STATEMENT OF THE CASE

JAMES EARL DAVIS ("DAVIS") was a dishonest financial planner who embezzled money from the Plaintiffs. As a result, DAVIS was convicted of mail fraud for

his thefts from the Plaintiffs and others, and is currently in prison.

The Plaintiffs then filed this civil action against AMERICAN GENERAL seeking to recover their losses. In their complaint, the Plaintiffs alleged 13 separate causes of action asserting primary and secondary violations of section 10(b) of the Securities Exchange Act of 1934 ("the Exchange Act")[1], and rule 10(b)-5 promulgated thereunder by the Securities Exchange Commission[2]; plus violations of sections 12(2) and 15 of the Securities Act of 1933[3]. The Plaintiffs also stated claims for relief based on alleged violations of state law, which were present in the federal court because of the principle of pendent jurisdiction.

The case proceeded to trial and, at the conclusion of the evidence, the district court regarded the facts most favorably to the Plaintiffs and found that: (1) AMERICAN GENERAL was *not* a "broker-dealer" of securities; (2) AMERICAN GENERAL nevertheless *could* be liable as a "controlling person," because DAVIS was under the power or influence of AMERICAN GENERAL; but (3) as a matter of law, AMERICAN GENERAL proved that it had no knowledge of or reasonable grounds to believe that DAVIS was embezzling from the Plaintiffs. Therefore, the district court directed a verdict for AMERICAN GENERAL on the securities claims only. The remainder of the Respondents' case based on negligence and agency

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[1] 15 U.S.C. section 78j(b).

[2] 17 C.F.R. section 240.10b-5.

[3] 15 U.S.C. section 771(2).

was submitted to the jury, which returned a verdict in favor of the Respondents, but awarded them no damages.

The Plaintiffs appealed, asserting, among other errors, that the district court erred in directing a verdict on the securities claims. The court of appeal *affirmed* with respect to the various evidentiary issues raised by the Plaintiff, *affirmed* that AMERICAN GENERAL had established the "good faith" defense to "control person" liability as a matter of law; but *reversed in part*, holding that:

> [T]he district court did err in directing a verdict in favor of AMERICAN GENERAL "as to all of the securities claims," for in so doing it erroneously directed a verdict on the Plaintiffs' respondeat superior theory of liability. It would not have been unreasonable for the jury to conclude that AMERICAN GENERAL was responsible for DAVIS' actions under a theory of respondeat superior.

(Pet. Exh. B, p. 3; citations omitted.)

II.

REASONS FOR GRANTING THE WRIT

A. The Decision of the Court of Appeals for the Ninth Circuit, Along with the Decisions of the First, Second, Eighth and Tenth Circuits, Conflicts with the Decisions of the Third, Fourth and Sixth Circuits.

Under section 20(a) of the Exchange Act a "controlling person [who] acted in good faith and did not directly

or indirectly induce the act or acts constituting the violation or cause of action" is not liable for the controlled person's violation of any provision of the Exchange Act or rule or regulation thereunder.

In spite of that express language, the Ninth Circuit in this case – relying on its own decision in *Hollinger v. Titan Capital Corporation*, 914 F.2d 1564 (9th Cir. 1990) (en banc), *cert. denied*, 111 S.Ct. 1621 (1991) – held that the limitation on secondary liability set forth in section 20(a) is *not available* to principals, and that principals can be held *strictly liable* under the Exchange Act for the acts of their agents under the common-law doctrine of respondeat superior.

In that respect, the Ninth Circuit agrees with the First,[4] Second,[5] Fifth,[6] Eighth,[7] and Tenth[8] Circuits. In

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[4] *In re Atlantic Fin. Management, Inc.*, 784 F.2d 29 (1st Cir. 1986), *cert. denied*, 481 U.S. 1072 (1987). In *Atlantic*, however, the First Circuit distinguished between "respondeat superior," a status-based agency liability theory, and "apparent authority," an authority-based agency liability theory, and held that section 20(a) does not preclude assertion of liability based only on common law notions of "apparent authority." *Id.* at 35.

[5] *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980).

[6] *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980).

[7] *Commerford v. Olson*, 794 F.2d 1319 (8th Cir. 1986).

[8] *Kerbs v. Fall River Industries, Inc.*, 502 F.2d 731 (10th Cir. 1974). *But see Castleglen, Inc. v. Commonwealth Savings Ass'n*, 689 F.Supp. 1069, 1071 (D. Utah 1988) (the Tenth Circuit in *Kerbs* "never discussed the effect of section 20(a) on respondeat superior liability"), *Seattle-First National Bank v. Carlstedt*, 678 F.Supp. 1543, 1548 n. 1 (W.D. Okla. 1987) ("there is some question as to

contrast, section 20(a) has been utilized as the *sole means* of imposing secondary liability under the Exchange Act under decisions of the Third,[9] Fourth,[10] and Sixth[11] Circuits.

By engrafting the common-law doctrine of respondeat superior onto the Exchange Act as a means of imposing secondary liability, the First, Second, Fifth, Eighth, Tenth, and now Ninth Circuits have eviscerated the legislative scheme. Under the decisions in those circuits, principals can be held strictly liable[12] under the Exchange Act for a violation of the Act by an agent regardless of fault.

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whether 'agency' or *respondeat superior* theories state a basis for recovery under the federal securities laws").

[9] *Sharp v. Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982). In *Sharp*, however, the Third Circuit announced an "exception" that permits use of respondeat superior to impose liability under the Exchange Act against "brokerage firms" and "accounting firms that render investment-oriented opinion letters." 649 F.2d at 181-82.

[10] *Carpenter v. Harris, Uphan & Co., Inc.*, 594 F.2d 388 (4th Cir. 1979). *But see Carras v. Burns*, 516 F.2d 251 (4th Cir. 1975). The apparent conflict between these Fourth Circuit decisions has yet to be resolved.

[11] *Holloway v. Howerdd*, 536 F.2d 690 (6th Cir. 1976). The Ninth Circuit in the *Hollinger* case cited *Holloway* as support for its decision, *Hollinger v. Titan Capital Corporation*, 914 F.2d 1564, 1576, n. 27 (9th Cir. 1991), *cert. denied* (1991), while the dissent cited it as a decision in which a circuit court of appeals declined to impose liability under the Exchange Act based on respondeat superior. *Id.* at 1582-83. (Hall, J., dissenting).

[12] Respondeat superior is a strict liability doctrine. See Restatement (Second) of Agency section 219 (1958) (a master is liable for the torts of his servants committed while acting in the scope of their employment).

By incorporating respondeat superior into the Exchange Act, these circuit courts of appeals have discarded the state of mind restrictions on liability included by Congress in section 10(b) of the Act[13] and treated the language of section 20(a) of the Act as mere surplusage.

In this case, as in *Hollinger*, the Ninth Circuit cast aside over 20 years of precedent[14] establishing that section 20(a) supplants the common-law doctrine of respondeat superior in Exchange Act cases. The Ninth Circuit's stated reasons for that reversal – as enunciated in *Hollinger* – were that section 20(a) was "intended to expand rather than to restrict the scope of liability under the securities laws"[15] and that "[o]nly if both respondeat superior and section 20(a) are available is the statutory scheme comprehensive and the public protected by the federal securities laws."[16]

Such reasoning ignores the rules of statutory construction for determining the scope of liability established by this Court in its decisions. As this Court recently stated with respect to the scope of liability of the Securities Act:

> The ascertainment of congressional intent with respect to the scope of liability created by a particular section of the Securities Act must rest

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[13] In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), this court held that an intent to deceive, manipulate, or defraud is required for civil liability under section 10(b) and rule 10b-5.

[14] *See Kamen & Co. v. Paul H. Aschkar & Co.*, 382 F.2d 689 (9th Cir. 1967), *cert. dismissed*, 393 U.S. 801 (1968).

[15] 914 F.2d at 1577.

[16] *Id.*

> primarily on the language of that section. See Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 472, 51 L.Ed.2d 480, 97 S.Ct. 1292 (1977). The broad remedial goals of the Securities Act are insufficient justification for interpreting a specific provision " 'more broadly than its language and the statutory scheme reasonably permit.' " Touche Ross, 442 U.S., at 578, 61 L.Ed.2d 82, 99 S.Ct. 2479, quoting SEC v. Sloan, 436 U.S. 103, 116, 56 L.Ed.2d 148, 98 S.Ct. 1702 (1978). We must assume that Congress meant what it said.[17]

The Ninth Circuit's ascertainment of Congressional intent in this case rested not on the language of section 20(a), but rather, on its perception of the need to make the statute "comprehensive" and thus protect "the public." The language of section 20(a) of the Exchange Act, however, does not limit the good faith defense to controlling persons other than principals.

Moreover, no other language in the Exchange Act suggests that Congress intended for respondeat superior to apply to impose strict liability under the Exchange Act.[18] This Court should therefore resolve the conflict among the circuit courts of appeals by holding that the common-law doctrine of respondeat superior is not applicable to Exchange Act claims, and that the good faith defense of section 20(a) is available to all controlling persons, including principals.

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[17] *Pinter v. Dahl*, 486 U.S. 622, 653 (1988).

[18] On the contrary, section 28(a) reflects that the provisions of the Exchange Act do not preempt state law rights and remedies.

B. The Decision of the Court of Appeals Conflicts with this Court's Decision in *Ernst & Ernst v. Hochfelder* and with the Express Language of Section 20(a) of the Securities Exchange Act of 1934.

In *Ernst & Ernst v. Hochfelder,*[19] this Court considered whether negligent conduct would suffice to impose civil liability under section 10(b) of the Exchange Act and rule 10b-5 promulgated thereunder, or whether scienter – an intent to deceive, manipulate or defraud – is required. In adopting the latter requirement, this Court concluded:

> There is no indication that Congress intended anyone to be made liable [under the Exchange Act] for [manipulative and deceptive] practices unless he acted other than in good faith. The catch-all provision of § 10(b) should be interpreted no more broadly.[20]

While in *Hochfelder,* this Court determined that Congress contemplated scienter rather than negligence as a requirement for imposition of civil liability under section 10(b), the Ninth Circuit in this case has eliminated any state of mind condition or fault requirement under section 10(b) by holding that principals can be held *strictly liable secondarily* for violations of section 10(b) and rule 10b-5 by their agents.

The Ninth Circuit's decision not only conflicts with the decision in *Hochfelder* concerning liability under section 10(b), it also contravenes the express language of

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[19] 425 U.S. 185 (1976).

[20] *Id.* at 206.

section 20(a) of the Exchange Act which exculpates a controlling person from liability for the acts of a controlled person if the controlling person "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."[21] And, while the Court in *Hochfelder* did not directly address the applicability of respondeat superior to the Exchange Act, it cited section 20(a) as evidence supporting its conclusion that "[e]ach of the provisions of the 1934 Act that expressly create civil liability . . . contains a state of mind condition requiring something more than negligence."[22]

Since Congress requires "something more than negligence" in both section 20(a) and section 10(b) for civil liability under those sections, the Ninth Circuit has undermined Congress' legislative scheme and this Court's holding in *Hochfelder* by imposing strict liability under respondeat superior on principals for violations of section 10(b) by their agents. Nothing in section 20(a) or any other provision of the Exchange Act suggests that the scope of the "good faith" defense of section 20(a) should be limited to controlling persons other than principals. As this Court noted in *Hochfelder* "the language of a statute controls when sufficiently clear in its context"[23] and

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[21] The Securities and Exchange Commission has defined "control" under both Acts as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. section 230.405; 17 C.F.R. section 240.12b-2.

[22] 425 U.S. at 209 n. 28.

[23] *Id.* at 201.

"there is no occasion to examine . . . additional considerations of 'policy'."[24]

The Ninth Circuit's decision was based on policy considerations and contravenes the express language of section 20(a) of the Exchange Act and this Court's holding in *Ernst & Ernst v. Hochfelder.* Thus, the instant case requires an exercise of this Court's power of supervision.

C. The Decision of the Court of Appeals Raises An Important Federal Question That Has Not Been, But Should Be, Settled By The Court.

The decision of the court of appeals in this case raises the question of the applicability of common-law doctrines to the Exchange Act. This is an important question that has not been, but should be, settled by this Court. The Ninth Circuit's conclusion that section 20(a) "was intended to expand rather than to restrict the scope of liability under the securities laws"[25] and that therefore respondeat superior applies to the Exchange Act begs the question whether the common-law doctrine of respondeat superior was intended by Congress as a means of imposing liability under the Act. Congress clearly was cognizant of agency concepts in drafting the securities laws. An example of a means of "control" set forth in the Securities Act is "agency."[26] Agency is therefore one method of establishing the controlling person relationship under section 20(a).

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[24] *Id.* at 214 n. 33.

[25] 914 F.2d at 1577.

[26] 15 U.S.C. section 77o.

Much less logical is the Ninth Circuit's conclusion that a common-law theory of secondary liability relating to agency should be applied to the statutory framework of the Exchange Act, especially when that theory's state of mind requirement for imposing liability is so far removed from scienter, the requirement for both primary liability under section 10(b) and secondary liability under section 20(a).

In *Hochfelder* this Court reserved the question whether the common-law doctrine of aiding and abetting liability could be used to impose liability under the Exchange Act, but implied that any such liability would need to be based upon a finding of scienter.[27] In this case, the Ninth Circuit held to the contrary by permitting imposition of secondary liability for violations of section 10(b) on a strict liability basis under respondeat superior. Since the applicability of common-law doctrines to the Exchange Act is an important federal question that has not been, but should be, settled by this Court, a writ of certiorari should be granted.

III.

CONCLUSION

A review of the issue in this case by this Court will resolve a conflict among the circuit courts of appeals, settle a conflict between a decision of a court of appeals and an applicable decision of this Court, and answer the

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[27] 425 U.S. at 191, n. 7.

question whether common-law doctrines apply to impose liability under the Securities Exchange Act of 1934.

For those reasons, Petitioner respectfully requests that this petition for certiorari be granted.

Dated: September 1, 1992

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JOHN MORRIS
Attorneys for Petitioner, American General Life Insurance Company of Delaware

APPENDIX A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

John R. DeShurley, et. al. Plaintiff, v. James Earl Davis, et. al. Defendant.	Case No. 89-0887-GT ORDER (Filed Oct 25 1990)

At the close of plaintiff's case, defendants brought a motion for a directed verdict pursuant to FRCP 50(a). Defendants seek a directed verdict on plaintiffs' first, second, and third claims for relief, all brought pursuant to the Federal Securities laws, and a directed verdict on plaintiff's claims for punitive damages. After considering the motion papers and arguments of counsel, the court grants the motion for directed verdict as to the Federal Securities Claims, and denies the motion for directed verdict as to plaintiff's claims for punitive damages.

On a motion for a directed verdict, the court is to consider whether there is no controversial issue of fact upon which reasonable men can differ. *Brady v. Southern Railroad* 320 U.S. 476 (1942). The facts are to be considered in the light most favorable to the non-moving party.

In California, punitive damages may be recovered where "it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or

malice . . . " California Civil Code §3294 (a). 1987 Amendments to this statute established that the oppression, fraud or malice must be proven by clear and convincing evidence in order for punitive damages to be appropriate.

Section 3294 (b) of the California Civil Code provides that

> An employer shall not be held liable for damages pursuant to subdivision (a), based upon acts of an employee of the employer, unless the employer had advance notice of the unfitness of the employee and employed him or her with a conscious disregard of the rights or safety of others or authorized or ratified the wrongful conduct for which the damages are awarded or was personally guilty of oppression, fraud or malice. With respect to a corporate employer, the advance knowledge and conscious disregard, authorization, ratification, or act of oppression, fraud or malice must be on the part of an officer, director, or managing agent of the corporation.

Taking the facts in the light most favorable to the plaintiffs, the court cannot find that there are no controversial facts upon which reasonable men may differ. Davis may have been an employee of American General Life Insurance, rather than an "independent contractor". Mr. Huse could be found to be a managing agent. A reasonable man could find that Huse had the opportunity to discover the fraud, and hence ratified the fraud through his failure to investigate and dismiss Davis sooner than he did. *See Pusateri v. E.F. Hutton & Co.* 180 Cal. App. 3d 247 (1986).

As to the Federal Securities Claims, there is no evidence to support a finding of primary liability of American General Life Insurance under Section 12(2) of the Securities and Exchange Act of 1933 or Section 10(b) of the Securities Exchange Act of 1934. American General Life Insurance was not involved directly in the purchase or sale of securities.

The court also finds that even when viewing the evidence in a light most favorable to the plaintiffs, by law plaintiffs cannot hold American General vicariously liable under either Section 15 of the 1933 Act or Section 20 of the 1934 Act.

To prevail on the claims of vicarious liability, plaintiffs first have to establish that Davis sold securities to the plaintiffs. The Supreme Court has held that a "security" is a flexible rather than a static concept, "one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *Sec. v. Howey Co.* 328 U.S. 293, 299 (1946).

A reasonable man could find that the products sold to the plaintiffs by Davis were securities. If plaintiffs expected to get the same return every month, the financial product would be a fixed rate annuity. Since any risk in these annuities is born [sic] by the insurance company and not the insured, they have been held not to be securities. *See SEC v. Variable Annuity Life Insurance Company of America* 359 U.S. 65 (1959). However, if the annuity that Plaintiffs expected or understood they were to get was to fluctuate, based upon the success of the investment portfolio managed by the insurance company, it

would be a security. *Id.* at 71. Plaintiffs testified that they weren't exactly sure what they were purchasing. Davis has testified that he was selling fixed rate annuities, but his credibility is open to question. Plaintiffs have introduced evidence that a fixed return was available for only the first year, and that thereafter the return fluctuated. Based upon all of the evidence presented, a reasonable man could find that this was a variable rate annuity.

If these products were securities, plaintiff must then show that American General Life Insurance is vicariously liable as a control person under Section 15 of the 1933 Act or Section 20 of the 1934 Act. For the purposes of this discussion, the interpretation of "control person" under the two acts is similar.

Plaintiff argues that *Hollinger v. Titan Capital,* No. 87-3837, filed September 27, 1990 is new ninth circuit law which leads to the liability of American General Life Insurance as a controlling person. In the court's view this is not the holding of *Hollinger.* The holding in *Hollinger* is stated plainly: "Today we hold that a broker-dealer is a controlling person under §20(a) with respect to its registered representatives." *Hollinger,* slip op. at 12093.

This holding is a change in 9th Circuit law, but it by the facts of the case and by the court's own statement at note 23 of its opinion, the court only reached a determination that broker-dealers are liable as controlling persons. It cannot be found under the facts of this case that American General Life Insurance was a broker-dealer of securities.

The analysis used in this circuit to analyze whether a secondary defendant who is *not* a broker-dealer can be

liable as a controlling person has two prongs. Under the first prong, plaintiff must show that the defendant had actual power or influence of the alleged controlled person. *Buhler v. Audio Leasing corp.*[sic] 807 F. 2d 833, 835 (9th Cir. 1987). Taking the evidence must favorable to plaintiff in this case, Davis was under the power or influence of American General Life Insurance Company. This court does read *Hollinger* as changing the law in this circuit as to the second prong of the controlling person analysis found in *Buhler.* Previous to *Hollinger,* it was plaintiff's burden to show that a defendant had actual power or influence over the alleged controlled person and "2), the defendant was a culpable participant in the alleged illegal activity." *Buhler* at 835. In *Hollinger,* the court held that the statutory language of Section 20(a) of the 1934 Act indicated that once the plaintiff has established that the defendant is a "controlling person", "then the defendant bears the burden of proof as to defendant's good faith." *Hollinger* at 12098.

Section 15 of the 1933 Act is worded differently, but with a similar result if one reads the statute consistent with the analysis found in *Hollinger.* A controlling person is liable to the extent of such controlled person "unless the controlling person had no knowledge of or reasonable grounds to believe in the existence of facts by reason of which the liability of the controlled person is alleged to exist." The burden to show that defendant had "no knowledge of or reasonable grounds to believe" in the alleged fraud is with the defendant.

The court finds that American General Life Insurance has met its burden of showing that it was not culpable and that it had "no knowledge of or reasonable grounds

to believe" in the alleged fraud of Mr. Davis. There has been no direct evidence of culpability or of knowledge of the fraud. Indirectly, plaintiffs infer that agents of American General Life Insurance should have discovered the fraud through its supervision of Davis, as a result of phone calls from Davis's [sic] clients, or by receiving a copy of one of Davis's [sic] clients phony financial statements.

The court finds that on the evidence as presented, there was no reasonable grounds for American General Life Insurance to believe that a fraud was being committed. As to the inquiries to its offices, American General Life Insurance has presented evidence that its agents followed up on these inquiries, and directed those inquiries to either Davis or to other parties who would be knowledgeable as to the inquiry. As to any alleged failure to investigate, mere inaction on the part of American General Life Insurance does not constitute culpability of a controlling person under the securities laws. *Christoffel v. E.F. Hutton Company*, 588 F.2d 665, 669 (1978). This court finds that a reasonable person could not find that American General Life Insurance is culpable under the securities laws on the evidence presented.

IT IS SO ORDERED.

/s/ Gordon Thompson, Jr.
GORDON THOMPSON, JR.
United States District Judge

Dated: October 25, 1990

APPENDIX B

Not for Publication

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN R. DESHURLEY; MARGARET J. DESHURLEY; BETTY J. WHITTAKER, Plaintiffs-Appellants, v. JAMES EARL DAVIS aka Jim E. Davis, et. al., Defendants, and AMERICAN GENERAL LIFE INSURANCE COMPANY, a Delaware corporation, Defendant-Appellee.	No. 91-55320 D.C. No. CV-89-0887-GT MEMORANDUM* (Filed Mar 19 1992)

* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

Appeal from the United States District Court
for the Southern District of California
Gordon Thompson, Jr., District Judge, Presiding

Argued and Submitted February 7, 1992
Pasadena, California

Before: TANG, KOZINSKI and TROTT, Circuit Judges.

A. The district court did not abuse its discretion in ruling that plaintiffs' securities expert could not testify regarding the methods insurance companies normally use to supervise their agents because he had not been qualified as an expert in corporate management or corporate personnel. *United States v. Marabelles*, 724 F.2d 1374, 1381-82 (9th Cir. 1984).

B. Nor did the district court abuse its discretion in barring plaintiffs from asking Robert Hughes whether American General Life encouraged him to use the idea of financial planning as a marketing tool; such testimony was irrelevant. *See Coursen v. A.H. Robins Co.*, 764 F.2d 1329, 1333 (9th Cir.), *amended*, 773 F.2d 1049 (9th Cir. 1985). Moreover, following this ruling the plaintiffs failed to preserve their objection by making an offer of proof as to the substance of the excluded evidence. *See id.*; Fed. R. Evid. 103(a)(2).

C. The district court's written instructions to the jury were neither incomplete nor erroneous, and they did not materially differ from the court's oral instructions.

D. The district court did not err in finding that American General Life's "control person" liability was to be judged against the lesser standard of good faith applicable to non-broker/dealers. *See Kersh v. General Council of the Assemblies of God*, 804 F.2d 546, 550-51 (9th Cir.

1986). The court also did not err in finding that the evidence permitted only one reasonable conclusion: that American General Life had proven that it acted in good faith at all times relevant to this litigation. *See Kersh*, 804 F.2d at 552; *Zweig v. Hearst Corp.*, 521 F.2d 1129, 1135-36 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975); *see also Hollinger v. Titan Capital Corporation*, 914 F.2d 1564, 1575 (9th Cir. 1990) (en banc) (defendant bears burden of proving good faith), *cert. denied*, 111 S. Ct. 1621 (1991).

E. However, the district court did err in directing a verdict in favor of American General Life "as to all of the securities claims," RT 1519, for in so doing it erroneously directed a verdict on the plaintiffs' respondeat superior theory of liability. *See Hollinger*, 914 F.2d at 1577-78; *see also* Plaintiffs' Consolidated Opposition to American General's Motions for a Directed Verdict 33-34 (arguing that a directed verdict on the securities claims is improper because American General Life is liable under respondeat superior). It would not have been unreasonable for the jury to conclude that American General Life was responsible for Agent Davis' actions under a theory of respondeat superior. Indeed, the jury apparently found American General Life liable on plaintiffs' state law claims on the basis of respondeat superior. And the district court itself noted that "[t]aking the facts in the light most favorable to the plaintiffs, . . . Davis may have been an employee of American General Life" and "Davis was under the power or influence of American General Life." Order Entering Directed Verdict for American General Life, Oct. 25, 1990, at 2 & 5.

AFFIRMED IN PART, REVERSED IN PART.

APPENDIX C

Not for Publication

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOHN R. DESHURLEY; MARGARET J. DESHURLEY; BETTY J. WHITTAKER, Plaintiffs-Appellants, v. JAMES EARL DAVIS aka Jim E. Davis, et. al., Defendants, and AMERICAN GENERAL LIFE INSURANCE COMPANY, a Delaware corporation, Defendant-Appellee.	No. 91-55320 D.C. No. CV-89-0887-GT ORDER (Filed June 8, 1992)

Before: TANG, KOZINSKI and TROTT, Circuit Judges.

The petition for hearing is denied. The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote thereon. The suggestion for rehearing en banc is therefore rejected. Fed. R. App. P. 35.

APPENDIX D

STATUTUES AND REGULATIONS INVOLVED

Securities Act of 1933

Section 12(2), 15 U.S.C. § 771(2):

Any person who –

* * *

(2) Offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 15, 15 U.S.C. § 77o:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

Securities Act of 1934

Section 10(B), 15 U.S.C. § 78j(b):

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 20(a), 15 U.S.C. § 78t(a):

> (a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Section 28(a), 15 U.S.C. § 78bb(a):

> (a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

Securities and Exchange Commission,

17 C.F.R. § 230.405:

> Unless the context otherwise requires, all terms used in §§ 230.400 to 230.494, inclusive, or in the forms for registration have the same meanings as in the Act and in the general rules

and regulations. In addition, the following definitions apply, unless the context otherwise requires:

* * *

Control. The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

17 C.F.R. § 240.10B-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

17 C.F.R. § 240.12b-2:

Unless the context otherwise requires, the following terms, when used in the rules contained in this regulation or in Regulation 13A or 15D or in the forms for statements and reports filed pursuant to sections 12, 13 or 15(d) of the act, shall have the respective meanings indicated in this rule:

* * *

Control. The term "control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.